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SNET

Rochelle D. Jones
Director-Regulatory

March 23, 1993

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Ms. Donna R. Searcy
Federal Communications Commission
Room 222
1919 M Street, N.W.
Washington, D.C. 20554

Re: CC Docket No. 92-24
Local Exchange Carrier Line Information Database **EX PARTE**

Dear Ms. Searcy:

The Southern New England Telephone Company (SNET) is

[redacted]

The following is SNET's response to an informal data request by the Common Carrier Bureau regarding SNET's LIDB rates -- specifically, SNET's STP Port Termination charge.

ISSUE:

Is SNET's Direct Cost Factor for SNET's STP Port Termination charge reasonable? As shown in SNET's Transmittal No. 533, filed January 4, 1992, and in SNET's response to the Commission's December 1992 data request, the Direct Cost Factor (ratio of direct costs to total investment) was 33.38%. This factor slightly exceeds a composite Direct Cost ratio of 29.58% calculated using 1991 ARMIS data for the total Traffic Sensitive category.

SNET RESPONSE:

As shown in its analysis following, SNET's direct cost factor for the STP Port Termination is both reasonable and appropriate. The Commission's analysis inappropriately compares a service-specific direct cost factor, developed using an incremental forward looking cost methodology, with an ARMIS factor that reflects composite historical data.

To begin, the comparison of direct costs to investment ratios for a new service (or specific rate element of a new service) cannot be expected to match an ARMIS direct cost ratio reflecting an average of several investment accounts. Each new service has a unique investment and experience profile that varies substantially depending upon the underlying technology, mode of service delivery and ongoing administrative and maintenance costs. In SNET's original tariff filing, SNET developed costs specific to the Port Termination element. The investments and capital related costs included two accounts - Digital Switching that accounted for 94% of the total investment, and Circuit Equipment, that

accounted for the remaining 6%. Expenses included were also specific to the Port Termination.

Exhibit 1 shows, by investment account type, each Port Termination cost element as a percent of gross investment, and a comparison to composite Traffic Sensitive data extracted from ARMIS. This comparison identifies the variances between the Port Termination costs and the ARMIS data, a result that is expected considering the differences in the data sources.

SNET contends that it is inappropriate to apply historical data from ARMIS, that includes embedded plant with inappropriately high levels of accrued depreciation, to forward looking data. Using such data as a benchmark for evaluating the reasonableness of rates for new services that do not use embedded investment is simply an inappropriate comparison.

In conformance with the Commission's price cap rules for new services, SNET completed a prospective two year cost study. The net investments used by SNET to calculate the Port Termination charge do not include the significant accumulated depreciation reserves or amortized deferred taxes found in the ARMIS data. Because the Commission's calculation of net return is based on net investment, using those historical reserves and taxes does not properly represent the net investment associated with the Port Termination.

Exhibit 2 demonstrates that an adjustment of the ARMIS data for a comparable level of net investment creates a direct cost upper limit that is above that proposed by SNET.

Given the above, SNET's STP Port charges are reasonable and appropriate. While the direct cost factor may be slightly higher than an ARMIS composite factor, there is no Commission rule which prohibits this variation. And indeed, SNET has shown, the

application of historical ARMIS data, that includes inappropriately high levels of depreciation accruals, should not be used to benchmark new service rates such as the Port Termination charge. SNET has properly identified the direct costs associated with this service, and in conformance with Commission requirements for new price cap services, has also applied a standard overhead loading factor. Its STP Port Termination rate is therefore well within prescribed and reasonable bounds.

Attachment

Exhibit 1 demonstrates: (1) the percentage of direct costs to total investment for SNET's ARMIS 1991 traffic sensitive category; (2) the corresponding percentage of direct costs to total investment for SNET's STP port termination study, for each investment category and for the total service; and (3) the difference between the ARMIS percentages and the STP port termination percentages.

There are differences between each of the ratios because the direct cost ratios for the components of the STP port termination were developed specific to that service; the ARMIS numbers are based on aggregates of several accounts not specific to the port termination. One large difference in the ratios is net return. For prospective studies the net return is higher because little of the investment has been prepaid over the study period. The ratio of net investment to gross investment in the cost study for the STP port termination is $27,083 to $29,149, or 92.91%. This is based on a prospective two year cost study. The ratio of net investment to gross investment (for COE+IOT+CWF) from the 1991 ARMIS Traffic Sensitive category is $146,617,000 to $308,112,000 or 47.59%. The reason for the large difference between the ratios is accumulated depreciation and amortized deferred taxes, which are higher for the embedded ARMIS totals and therefore result in a lower percentage of net to gross

Exhibit 1 – Comparison of Cost to Gross Investment Ratios for ARMIS and STP Termination Costs

	[redacted]		[redacted]			
Investment	1991 ARMIS Totals (000)	% of Total Investment	Digital Switching Acct 2212	Circuit Acct 2232	Weighted Total for Study	[redacted]

Exhibit 2 – ARMIS Data Adjusted to Reflect Net Investment Comparable to STP Port Termination Investment

	1991 ARMIS Total Traffic Sensitive		STP Port Termination			
	1991 ARMIS Totals (000)	% of Total Investment	Digital Switching Acct 2212	Circuit Acct 2232	Weighted Total for Study	Difference Between ARMIS & STP Port Term Cost Study
Investment						
1 Investment	$308,112		$27,400	$1,749	$29,149	
2 Investment-GSF	$102,499					
3 Tot L1+L2	$410,611					
4 COE+IOT+CWF factor L2/L3	75.04%					
5 GSF factor L2/LI3	24.96%					
Net Investment						
6 Net investment COE+IOT+CWF	$286,267				$27,083	
7 Net investment GSF	$58,014					
8 Total Net investmentL6+L7	$344,281					
9 Net investment factor COE+IOT+CWF L6/L8	83.15%					
10 Net investment factor-GSF (L7/L8)	16.85%					
Capital costs						
11 Plant specific expense-COE+IOT+CWF	$14,757	4.79%			4.88%	0.09%
12 Plant specific expense-GSF	$13,748					
13 Depreciation/amortization expense	$36,018					
14 Depr/Amort-COE+IOT+CWF	$27,792	9.02%	5.24%	8.75%	5.45%	
15 Depr/Amort-GSF	$8,226					
16 Federal Income Taxes	$5,994					
17 FIT-COE+IOT+CWF(L9*L16)	$4,564	1.48%	4.12%	2.47%	5.35%	
18 FIT-GSF (L10*L16)	$1,430					
19 State & Local Taxes	$6,533					
20 State & local income taxes	$3,747					
21 St & Local inc tax-COE+IOT+CWF(L9*L20)	$2,853	0.93%	2.37%	4.22%	2.48%	
22 St & Local inc tax-GSF(L10*L20)	$894					
23 Net return-COE+IOT+CWF (L6*.1125)	$32,205	10.45%	11.60%	11.87%	11.62%	
24 Net return-GSF (L7*.1125)	$6,527					
25 Dir costs lower limit (Lns 11+14+17+21+23)	$82,171	26.67%	23.33%	27.31%	29.78%	